EASTERN PROVINCIAL AIRWAYS
Annual Report 1976

EASTERN PROVINCIAL AIRWAYS LIMITED
and Subsidiary Companies

OFFICERS

Andrew Chesley Crosbie,
Chairman of the Board

Arthur James Lewington,
Deputy Chairman of the Board

Keith Alfred Miller,
President and Chief Executive Officer

William Farrell Gaudet,
Vice-President Marketing

William Henry Harris,
Vice-President Government and Community Relations

Bryan Goodwin Jones,
Vice-President Engineering & Maintenance

Marshall Bruce Jones
Vice-President Flight Operations

Harold Lewis Wareham
Vice-President Finance & Planning

William James Whatley
Secretary

Roy Preston Rideout
Assistant Vice-President Finance

HEAD OFFICE
Gander International Airport,
Gander, Newfoundland

BANKERS
The Royal Bank of Canada, Gander, Nfld.
The Mercantile Bank of Canada, Montreal, P.Q.

AUDITORS
Peat, Marwick, Mitchell & Co.,
Chartered Accountants,
St. John's, Newfoundland

LEGAL COUNSEL
Herridge, Tolmie,
Ottawa, Ontario
Johnston, Heenan & Blaikie,
Montreal, P.Q.
Alyward & Crosbie,
St. John's, Newfoundland

TRANSFER AGENT & REGISTRAR
The Royal Trust Company,
St. John's, Halifax, Montreal,
Toronto, Winnipeg, Regina, Calgary

STOCK LISTING
The Toronto Stock Exchange
The Montreal Stock Exchange

DIRECTORS
Andrew Chesley Crosbie,
President & Chief Executive Officer,
Newfoundland Engineering and Construction Co. Ltd.,
St. John's, Nfld.

Arthur James Lewington,
Deputy Chairman of the Board,
Eastern Provincial Airways

**Keith Alfred Miller,
President & Chief Executive Officer,
Eastern Provincial Airways

Harold Anthony Collins,
Minister of Health
Province of Newfoundland & Labrador

Walter John Cox,
President, The Pure Milk Co. Ltd.,
Charlottetown, P.E.I.

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Partner, Herridge, Tolmie,
Ottawa, Ontario.

*William Farrell Gaudet,
Vice-President, Marketing
Eastern Provincial Airways

Richard Greene,
Partner,
Greene, McNab & Baird, St. John's, Nfld.

*William Henry Harris,
Vice-President, Government & Community Rels.
Eastern Provincial Airways

*Bryan Goodwin Jones,
Vice-President, Engineering & Maintenance
Eastern Provincial Airways

*Marshall Bruce Jones,
Vice-President, Flight Operations
Eastern Provincial Airways

Richard Henry Oland,
Officer Moosehead Breweries Limited,
Saint John, N.B.

Charles Arnold Patterson
President, C.F.D.R. Radio Station
Dartmouth, Nova Scotia

Harold Raymond Steele,
President, Atlantic Inns Limited
Gander, Nfld.

*Harold Lewis Wareham,
Vice-President, Finance & Planning
Eastern Provincial Airways

*Members of the Executive Committee
**Chairman of the Executive Committee

Contents

Comparative Highlights

	1976	1975
Earnings		
Revenues - Gross	$38,651,000	35,902,000
Net Loss	$ 1,083,000	190,000
Loss per Common Share - Basic	$ 1.03	0.27
Average Common Shares Outstanding	1,202,545	1,202,915
Financial Position		
Working Capital (Working Capital Deficiency)	$ (683,000)	1,133,000
Property and Equipment - Net	$25,831,000	22,808,000
Long-Term Debt	$16,591,000	17,643,000
Shareholders' Equity	$ 6,179,000	7,464,000
Equity per Common Share	$ 3.58	4.57
Operating Statistics		
Passengers Carried	593,000	604,000
Cargo Ton Miles	3,876,000	3,799,000
Revenue Ton Miles	26,340,000	27,575,000
Capacity Ton Miles	50,836,000	51,532,000
Revenue Weight Load Factor	51.8%	53.5%

Directors' Report to the Shareholders

The year 1976 was the most difficult in the recent history of the Company. For the first time since entering the jet age in 1969, the Airline experienced a decline in passengers carried on scheduled services. This factor, combined with escalating costs in the areas of aviation fuel, labour, and Government user charges, contributed to the poor financial results reported herein.

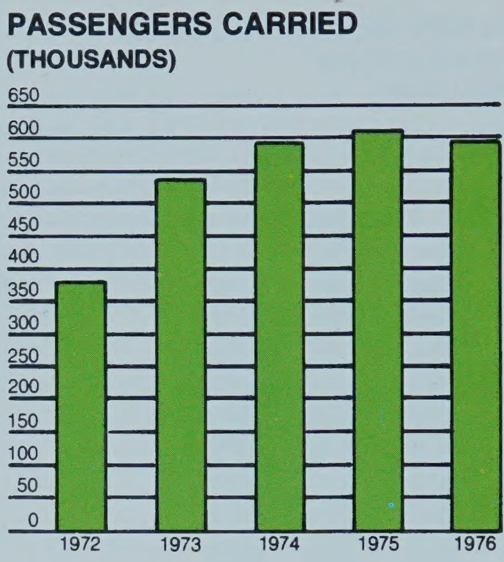
The Company incurred a net loss for the year of \$1,083,000 (\$1.03 per share) compared with a loss of \$190,000 (\$0.27 per share) in 1975. Revenues from all sources in 1976 amounted to \$38,651,000 compared with 1975 revenues of \$35,902,000, an increase of 8%. Operating expenses, excluding aircraft ownership costs, totalled \$35,520,000 compared with \$32,222,000 in 1975. This constitutes an increase of 10%.

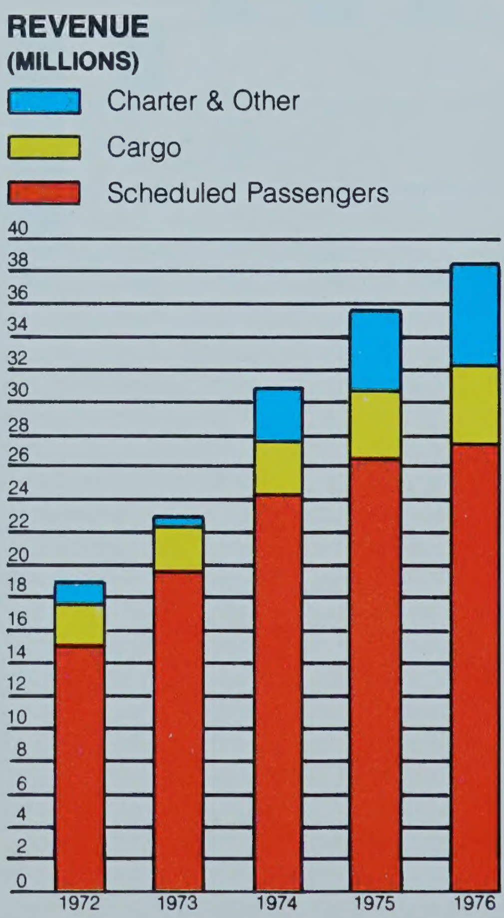
The increase in revenues is attributable chiefly to domestic fare increases of 9% and 6% granted in May and September of 1976 respectively. Additional revenue was derived from the lease of a Boeing 737 to an American carrier for a period of five months, as well as from the first full years operation of the Airline's wholesale tour subsidiary which was acquired late in 1975. The increase in revenues from these sources was partially offset by the continued deterioration in demand for air travel. The general decline in business traffic, compounded by the national disruption in air services in June of 1976, resulted in a 2% overall decrease in passengers carried on scheduled services. The staggering impact of the recession, which commenced in late 1974, is dramatically illustrated by traffic statistics for the last two years. The Airline actually carried fewer passengers on scheduled services in 1976 than it had in 1974.

Our last annual report mentioned certain steps taken by your management as a result of adverse traffic trends experienced during 1975. As a result of a continuation, and indeed deterioration, of these market conditions in 1976, further action became necessary to minimize 1976 losses and to maintain sufficient working capital. A Boeing 737 was leased for five months to Wien Air Alaska Inc, which substantially reduced idle aircraft capacity and contributed in excess of $500,000 to revenue. Additionally, the refinancing of a Boeing aircraft in March, 1976, through a sale/leaseback arrangement provided in excess of $2,000,000 in working capital and a gain of approximately $830,000 after provision for deferred income taxes. To further preserve working capital, dividends on Series A and Series B Preferred Shares were discontinued after September, 1976. Other efforts of your management to improve operating results are more fully described in the paragraphs which follow.

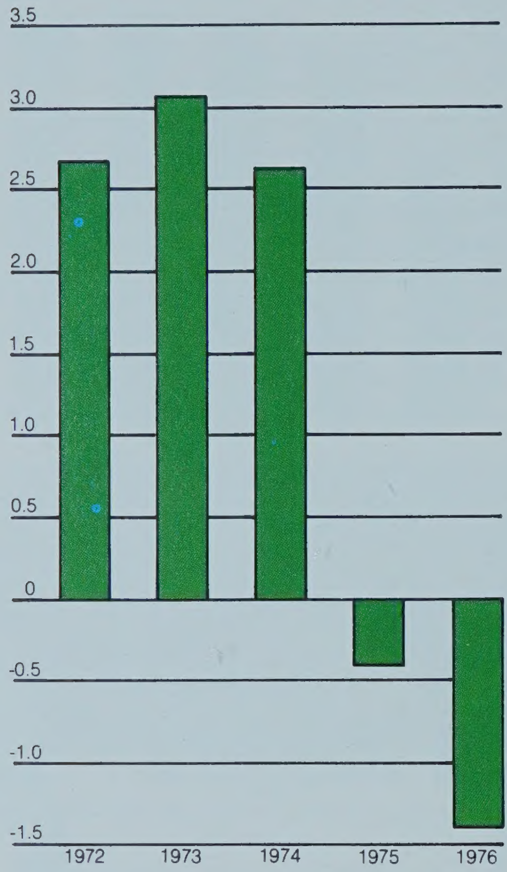
Included in total revenues of $38,651,000 is an amount of $1,700,000 paid to the Airline for the provision of air service over certain uneconomic routes which are eligible for federal subsidy. In 1975, subsidies were frozen at that level by the Federal Government. As a result of this arbitrary ceiling placed upon subsidy payments the Airline received approximately one half of the amount claimed for servicing subsidy-eligible routes in 1976. The subsidy claimed for the year was $3,372,000; the subsidy paid, $1,700,000 — a shortfall of $1,672,000. As mentioned in last year's report, the 1975 shortfall was $589,000. In December 1976, a formal appeal was made to the Minister of Transport requesting relief from the 1975 and 1976 subsidy ceilings. In March, 1977, this appeal was rejected with Government fiscal restraints being cited as the reason no further assistance was forthcoming. In the light of these developments, your management is currently taking a hard look at alternatives open to the Airline respecting the specific routes in question. The result of our analysis may mean a curtailment in service or outright abandonment of certain routes.

Included in the consolidated loss for the year are the operating results of the Airline's two subsidiaries, Atlantic Inns Limited and Caramac Travel Consultants Limited. The hotel subsidiary continues to show gratifying results and realized a small profit for the year after absorbing administration charges of $78,000 by the parent company. The tour subsidiary incurred a pre-tax loss of approximately $90,000. As was indicated in our last annual report the tour operation was not expected to break even in its first year of operation, which was chiefly an organizational and developmental year for the tour company.





FUNDS GENERATED FROM OPERATIONS
(MILLIONS)



Early in 1976 the Airline inaugurated a new Hawker Siddeley 748 turbo-prop service between Sydney, Nova Scotia and St. Pierre & Miquelon, France, replacing the previous DC-3 service. The termination of the DC-3 service marked the end of an era for the Airline in that it will no longer operate piston engine aircraft. An application has been made to the Canadian Transport Commission to operate direct service from Halifax, Nova Scotia to St. Pierre & Miquelon in order to serve the larger Halifax market and to provide travellers with better connections to and from overseas and mainland points. No ruling has yet been received on this application.

Major capital expansions at Halifax and Gander continued on schedule and within the capital cost budgets. The new Halifax hangar will be fully operational in May of 1977 and will house the Flight Training Centre, including a Boeing 737 Flight Simulator. Hawker Siddeley maintenance programs as well as Boeing 737 line maintenance have been carried out in the new hangar since November, 1976. The extension to the Engineering and Maintenance Facility at Gander will also be completed in May of 1977 and will provide additional capacity for the Company's heavy airframe maintenance program which was commenced in 1975, as well as housing for the Company's accounting and administrative personnel.

In January of 1977, the Airline's hotel subsidiary, Atlantic Inns Limited, expanded into the Halifax-Dartmouth area. A five year lease of a hotel building was signed with an option to purchase the building at any time during the term of the lease. This represents a further step in the Airline's diversification program. Additionally, plans for a $2,250,000 expansion project are now being considered for the Glynmill Inn located in Corner Brook, Newfoundland, to renovate and improve the existing building and to construct a new 30-room wing with improved banquet and entertainment facilities.

During July of 1976 a public hearing of the Airline's application to establish a subsidiary air network in Atlantic Canada took place in Halifax. As a result of the unfavourable ruling of the Canadian Transport Commission on this application, plans to operate the routes in question have been shelved and the Airline is no longer actively engaged in plans to establish a third level air carrier service.

The only major union contract negotiated during 1976 resulted in the first strike in the Company's history, as the Flight Attendants' group walked out in support of contract demands. Scheduled flights were maintained throughout the month-long strike through the use of

management and supervisory personnel. A satisfactory collective agreement was reached in September of 1976. All major contracts will expire during 1977 and the year will prove to be a busy one for union negotiations. The Airline is subject to the rules and regulations of the Anti-Inflation Board.

As mentioned in previous quarterly reports the Airline has conducted in-depth studies during 1976 aimed at rationalizing its complete network in order to achieve greater economic viability and to provide a better public service. An important element of the Company's plans is the apportionment of routes in Atlantic Canada between the regional and the trunk carrier. Negotiations between the two Airlines have been continuing since the fall of 1976 but have to date proven fruitless. It is your management's belief that the withdrawal of the national carrier from many of the purely regional routes which it operates within Atlantic Canada is essential to the long run viability of your Airline.

Another important issue to be resolved related to route rationalization is the attainment of a longer average stage length. It is the belief of your Company that the Airline must be awarded additional long haul routes in order to provide a sounder economic base for its operations. Traditionally the yield from short-haul operations has not been sufficient to reimburse the Company for the higher costs associated with lower stage distances. The proper mix of long-and short-haul routes is a key objective of your management in its attempts to improve the long-run prospects of the Airline. Consistent with this objective the Airline has applied for non-stop service between Halifax and Montreal and this application is now before the Canadian Transport Commission. No indication has been received as to when a decision will be forthcoming.

To restore depleted working capital and improve earnings your management has taken certain steps early in 1977 which are considered prudent in the existing circumstances. A financial arrangement has been negotiated with a commercial bank which will provide $4,500,000 in working capital. These funds will be refinanced on a long term basis later in the year. Continued inflationary trends in cost areas such as avaition fuel and labour has forced the Airline to apply for further increases in passenger fares and cargo and charter rates. These increases, which will average 6%, will become effective in late April, 1977. To further increase revenue, a Boeing 737 will be leased to Aloha Airlines, a Hawaiian carrier, for a period of six months commencing mid-June. This lease will improve aircraft utilization and provide in excess of $500,000 in rental revenues.

It is expected that the coming year will show an improvement over 1976 results. Traffic volumes for the first three months of 1977 on scheduled services indicate a growth rate in the area of 5%. Overall financial results for the first quarter were slightly ahead of budget and if this trend continues the Airline can anticipate reducing the loss originally forecasted to a break even position. Your management continues to review operating efficiencies to obtain optimum financial results. However, future profitability depends in large part upon the satisfactory resolution of the route rationalization issues referred to above, as well as upon general economic conditions in Atlantic Canada.

We are indebted to all Airline employees for their loyalty and hard work during this very difficult year.

On behalf of the Board of Directors.

K. A. Miller,
President & Chief Executive Officer.

Consolidated Statement of Earnings

YEAR ENDED DECEMBER 31, 1976
with comparative figures for 1975
(in thousands of dollars)

	1976	1975
Revenues		
Scheduled operations	$30,592	28,974
Government subsidies - Note 8	1,700	1,700
Charter and other	6,359	5,228
	38,651	35,902
Expenses		
Operating	39,043	34,769
Depreciation and amortization	1,772	1,762
	40,815	36,531
Loss from operations	2,164	629
Other income, including gain on sale of flight equipment - Note 9	1,501	1,553
	(663)	924
Interest and debt expense		
Long-term debt	1,486	1,377
Other	160	79
	1,646	1,456
Loss before deferred income taxes	2,309	532
Deferred income taxes	1,226	342
Net loss for the year	$ 1,083	190
Basic loss per Common share - Note 9	$ 1.03	0.27

See accompanying notes to consolidated financial statements

EASTERN PROVINCIAL AIRWAYS LIMITED
and Subsidiary Companies

Consolidated Statement of Changes in Financial Position

YEAR ENDED DECEMBER 31, 1976
with comparative figures for 1975
(in thousands of dollars)

	1976	1975
Funds applied to		
Net loss for the year	$ 1,083	190
Items not involving funds - net	277	215
Funds applied to operations	1,360	405
Property and equipment - Note 7 (d)	9,514	11,434
Long-term debt	5,725	6,608
Dividends	121	137
Deferred charges	309	480
Investments	–	262
Purchase for cancellation of Series A and Series B Preferred shares - Note 6	80	31
Total funds applied	17,109	19,357
Funds provided by		
Government grants in aid of construction	4,032	–
Sale of flight equipment	6,351	9,370
Long-term borrowings	4,673	6,876
Investments	237	–
Issue of capital stock	–	1,023
Transfer of property to "Asset held for disposal" - Note 7 (d)	–	1,605
Total funds provided	15,293	18,874
Decrease in working capital	1,816	483
Working capital as at beginning of year	1,133	1,616
Working capital (working capital deficiency) as at end of year	$ (683)	1,133

See accompanying notes to consolidated financial statements

Assets

	1976	1975
Current assets		
Cash and term deposits	$ 298	319
Short-term investments, at cost (market value $507,000; 1975 - $727,000)	560	868
Receivables - Note 2	4,992	5,405
Materials, supplies and parts, at lower of cost or replacement cost	1,646	1,312
Asset held for disposal - Note 7 (d)	–	1,605
Prepaid expenses	352	179
Total current assets	7,848	9,688
Investments, at cost	894	1,132
Property and equipment, at cost		
Flight equipment	18,076	23,215
Buildings and ground facilities	5,538	2,578
Assets under construction	6,897	541
	30,511	26,334
Less accumulated depreciation and provision for overhaul of owned aircraft engines	4,680	3,526
Net property and equipment	25,831	22,808
Deferred charges - Note 3	976	836
Goodwill, at cost	1,856	1,856
	$37,405	36,320

See accompanying notes to consolidated financial statements

Consolidated Balance Sheet

DECEMBER 31, 1976
with comparative figures for 1975
(in thousands of dollars)

Liabilities and Shareholders' Equity

	1976	1975
Current liabilities		
Bank indebtedness - Note 2	$ 1,423	1,310
Accounts payable and accrued liabilities	3,866	4,135
Current portion of long-term debt - Note 4	1,887	2,102
Deferred revenue	1,355	1,008
Total current liabilities	8,531	8,555
Long-term debt - Note 4	16,591	17,643
Provision for overhaul of leased aircraft engines	1,114	474
Government grants in aid of construction - Note 7 (c) and (d)	4,032	–
Deferred income taxes - Note 5	958	2,184
Shareholders' equity - Note 6		
Capital stock	3,329	3,433
Contributed surplus	37	14
Retained earnings	2,813	4,017
Total shareholders' equity	6,179	7,464
Commitments and contingent liabilities - Note 7		
	$37,405	36,320

ON BEHALF OF THE BOARD:

K. A. Miller (Signed) .... DIRECTOR

H. L. Wareham (Signed) .... DIRECTOR

EASTERN PROVINCIAL AIRWAYS LIMITED
and Subsidiary Companies

Consolidated Statement of Retained Earnings

YEAR ENDED DECEMBER 31, 1976
with comparative figures for 1975
(in thousands of dollars)

	1976	1975
Retained earnings as at beginning of year	$4,017	4,141
Net loss for the year	1,083	190
Realization of excess of appraised value of property and equipment over cost	–	203
	2,934	4,154
Dividends		
Preferred shares - Series A	42	58
- Series B	79	79
	121	137
Retained earnings as at end of year	$2,813	4,017

See accompanying notes to consolidated financial statements

AUDITORS' REPORT TO THE SHAREHOLDERS

We have examined the consolidated balance sheet of Eastern Provincial Airways Limited as at December 31, 1976 and the consolidated statement of earnings, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at December 31, 1976 and the results of its operations and changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Peat, Marwick, Mitchell & Co.
Chartered Accountants

St. John's,
Canada
February 25, 1977

Notes to Consolidated Financial Statements
DECEMBER 31, 1976

1. Summary of Significant Accounting Policies

(a) Basis of consolidation
The consolidated financial statements include the accounts of Eastern Provincial Airways Limited and its wholly-owned subsidiary companies, Maritime Central Airways Limited, Eastern Provincial Airways (1963) Limited, and Atlantic Inns Limited, as well as its 75% owned subsidiary, Caramac Travel Consultants Limited. The shares of Caramac Travel Consultants Limited were acquired on January 1, 1976 for consideration of $7,500.

Goodwill, representing the excess of cost of investment in shares of subsidiary over equity in net assets at date of acquisition amounting to $1,855,620, arose upon the acquisition of Maritime Central Airways Limited in 1963.

(b) Depreciation
Depreciation on property and equipment is provided on a straight-line basis from the date assets are placed in service at rates which are related to the estimated useful lives of the assets, as follows:

	Useful Life	Residual Value
Jet aircraft and spare parts	14 years	15%
Propeller aircraft and spare parts	10 years	10%
Buildings	20 years	–
Ground facilities	5 years	–

(c) Capitalization of interest
Interest is capitalized on expenditures related to the acquisition of property and equipment before such assets are placed in service.

(d) Overhaul provision
Provision for major overhauls of owned and leased aircraft engines which are performed by outside agencies is made based on aircraft flying time at rates per hour computed in relation to the estimated costs of the overhauls.

(e) Amortization
Deferred charges are amortized on a straight-line basis over five years with the exception of deferred financing expenses which are amortized over the terms of the related financing.

(f) Government grants in aid of construction
Government grants in aid of construction or purchase of property and equipment are recorded as deferred credits and amortized on the same basis as the related asset is depreciated.

(g) Revenue recognition
The recognition of revenue is deferred until the related services are rendered. Prepayments of such services as at the year end are included in deferred revenue.

(h) Foreign currency translation
Current balances receivable and payable in foreign currencies have been translated to Canadian dollars at the exchange rates prevailing as at the balance sheet date. Non-current balances in foreign currencies have been translated at historical rates of exchange. Gains and losses on translation of foreign currency are included in the statement of earnings.

(i) Income taxes
Income taxes are accounted for on the tax allocation basis in recognition of the income taxes deferred when deductions that are claimed for income tax purposes are greater than corresponding expenses recorded in the accounts.

(j) Earnings per Common share
Basic earnings per share information has been computed using the weighted average number of Common shares outstanding during the year.

2. Receivables

Receivables are summarized as follows:

	1976	1975
	(in thousands of dollars)	
Trade receivables	$3,151	3,014
Due on sale of aircraft	–	968
Government subsidies	800	500
Recoverable construction costs	473	476
Other receivables	568	447
	$4,992	5,405

Receivables are assigned as security for bank indebtedness.

3. Deferred Charges

Deferred charges are carried at cost less accumulated amortization and are summarized as follows:

	1976	1975
	(in thousands of dollars)	
Training expenses	$ 318	243
Financing expenses	440	362
Crew transfer expenses	218	231
	$ 976	836

4. Long-Term Debt

Long-term debt is summarized as follows:

	1976	1975
	(in thousands of dollars)	
$6^1/_2$ sinking fund debentures due March 15, 1991, less sinking fund investments of $3,889,000 (1975 - $3,868,000)	$2,111	2,132
8% conditional sale agreement, repaid in March 1976 upon the sale and leaseback of an aircraft	–	4,197
Bank loan, at prime plus 1%, repayable March 31, 1977	300	540
6% term loan repayable in 10 equal semi-annual instalments commencing July 10, 1980, guaranteed by a Canadian bank holding a chattel mortgage on an aircraft	2,562	2,562
Bank loan, at prime plus $2^1/_8$%, repayable in 10 equal semi-annual instalments to December 31, 1979, secured by a chattel mortgage on an aircraft	2,340	3,120
8% term loan, repayable in 8 semi-annual instalments commencing May 10, 1982, guaranteed by a Canadian bank holding a chattel mortgage on an aircraft	2,345	2,211
Bank loan, at prime plus 2%, repayable in 25 quarterly instalments of $162,500 to March 31, 1982, and a final payment of $137,500 on June 30, 1982, secured by a chattel mortgage on an aircraft	3,550	4,200
11% financing advances - Note 7 (c)	3,422	383
$10^1/_2$% mortgage loan repayable in the years 1977 to 1981 in instalments of $100,000, $200,000, $300,000, $400,000 and $500,000 respectively - Note 7 (a)	1,500	–
Bank loan, at prime plus 2%, repayable in blended monthly instalments of $8,309 each to December 31, 1981, secured by a collateral mortgage on real property	348	400
	18,478	19,745
Less portion due within one year included in current liabilities	1,887	2,102
Long-term debt - net	$16,591	17,643

The sinking fund debentures are unconditionally guaranteed by the Province of Newfoundland; this guarantee being secured by a first and specific mortgage on certain assets and a first floating charge on certain other assets. It is the intention that the sinking fund investments together with future earnings of the fund will be sufficient to retire the principal amount of the sinking fund debentures at maturity.

In connection with certain loan and lease agreements the company has agreed to maintain on a consolidated basis a minimum net worth, as defined, of $7,000,000, and has also agreed that Eastern Provincial Airways (1963) Limited will, among other things:

(a) Maintain a minimum working capital, as defined, of $1,000,000 until December 31, 1976, and $1,500,000 thereafter;

(b) Not declare or pay dividends in any one year in excess of 50% of its net earnings for the previous year; and,

(c) Not make capital expenditures in excess of $500,000 in any one year without prior written consent of the lessors and lenders.

As at December 31, 1976, the company is in default of certain of the covenants contained in these loan and lease agreements relating to net worth and working capital. However waivers have been received from lessors and lenders indicating that they do not intend to exercise their remedial rights under these agreements for defaults existing as at December 31, 1976.

Maturities on long-term debt other than $6^1/_2$% sinking fund debentures for the five years ending December 31, 1977 through 1981 amount to $1,887,000, $1,695,000, $1,804,000, $1,389,000 and $1,740,000 respectively.

5. Deferred Income Taxes

Deferred income taxes as at December 31, 1976, relate chiefly to the excess of capital cost allowance claimed for tax purposes over depreciation recorded in the accounts.

6. Capital Stock

	1976	1975
	(in thousands of dollars)	
Preferred shares of $15 par value each, issuable in series. Authorized - 135,000 shares. Series A - 6% cumulative, redeemable, convertible Preferred shares. Authorized 67,000 shares; issued and outstanding 59,940 shares (1975 - 63,440)	$ 899	952
Series B - 10¾ cumulative, redeemable Preferred shares. Authorized 68,000 shares; issued and outstanding 64,600 shares (1975 - 68,000)	969	1,020
Deferred shares of $100 par value each. Authorized 47,500 shares; issued and eliminated on consolidation 24,964 shares	–	–
Common shares without nominal or par value. Authorized 3,000,000 shares; issued 1,202,595 shares (1975 - 1,202,495)	1,461	1,461
Total capital stock	$3,329	3,433

Pursuant to the redemption conditions attaching to the Series A Preferred shares the company is required, while there are no dividends in arrears, to apply each year to the purchase for cancellation of these shares an amount equal to three percent of the aggregate par value of Series A Preferred shares outstanding at the end of the preceding year. During 1976 an amount of $28,700 was applied to the purchase for cancellation of 3,500 shares with an aggregate par value of $52,500.

Pursuant to the redemption conditions attaching to the Series B Preferred shares the company redeemed, at par value, 3,400 shares during 1976, for an aggregate consideration of $51,000, and is required to redeem, at par value, during the four years ending April 15, 1977 to 1980, 6,800 shares, 6,800 shares, 10,200 shares and 40,800 shares respectively.

As at December 31, 1976, dividends on Series A and Series B Preferred shares were in arrears in the amounts of $13,486 and $26,163 respectively.

In accordance with Section 49 of The Companies Act, Newfoundland, a portion of retained earnings equal to the par value of Preferred shares redeemed to December 31, 1976, totalling $148,500, has been appropriated as a "capital redemption reserve fund" which may not be reduced or converted except in accordance with provisions of the Act. The difference of $23,000 (1975 - $14,000) between the par value of the Preferred shares redeemed and the purchase price has been included in contributed surplus.

Series A Preferred shares are convertible into Common shares at the option of the shareholder on the basis of two Common shares for each Series A Preferred share. Pursuant to this conversion privilege 119,880 Common shares are reserved for issuance as at December 31, 1976 (1975 - 126,880). A further 99,000 Common shares are reserved for issuance to employees (other than present directors and officers) under a Stock Option Plan and a Stock Purchase Plan created in 1972. In 1974 share options were granted to employees under the Stock Option Plan to purchase 32,000 Common shares on or before December 12, 1979 at an exercise price of $2.65 per share. Pursuant to this plan 100 Common shares were issued during 1976 and options for 27,900 Common shares remained unexercised as at December 31, 1976. No shares have been offered under the Stock Purchase Plan as at December 31, 1976.

7. Commitments and Contingent Liabilities

(a) Aircraft leases

As at December 31, 1976, the company had the following aircraft lease commitments:

	Basic Annual Rental	Term Remaining
3 Boeing 737's	$1,702,000	8 years
1 Boeing 737	826,000	8½ years
1 Boeing 737	781,000	12½ years
1 Hawker Siddeley HS-748	183,000	11 years
1 Hawker Siddeley HS-748	174,000	8 years
	$3,666,000	

Related to one of the above lease agreements the company has indemnified a third party in respect of a loan which at December 31, 1976, had a balance of $7,221,000. To secure this indemnification and a 10½% loan of $1,500,000 received in 1976, the company has executed a specific mortgage on certain assets and a floating charge on other assets.

Pursuant to other lease agreements the company has pledged debentures in the amount of $575,000. These debentures are included in investments.

(b) Federal Sales Tax assessment
During 1974 the company received a Federal Sales Tax assessment in the amount of $562,000 relating to the purchase and importation of a Boeing 737 jet aircraft on October 29, 1973. Counsel for the company has advised that this assessment is not justified in law, and consequently the company has disputed this assessment and maintains that no part of this amount is, or will become, payable. Accordingly, no provision has been made for this amount in the accounts.

(c) Halifax hangar and training facility
During 1975 the company commenced construction of an aircraft hangar at Halifax at an estimated total cost of $4,100,000. Financing totalling $4,065,000 has been arranged with an agency of the Province of Nova Scotia at an interest rate of 11%. Expenditures on this project totalling $3,422,000 as at December 31, 1976, have been reimbursed under the financing agreements. Upon completion of the hangar the financing will be repaid in blended monthly instalments of approximately $42,000 each over a period of twenty years.

Related to this project the company has undertaken to establish a training facility, including the purchase of a Boeing 737 flight simulator, at an estimated total cost of $3,500,000. The Province of Nova Scotia has agreed to provide grants of up to $3,400,000 toward the cost of these facilities. As at December 31, 1976, advance payments made totalling $2,532,000 are included in property and equipment. Grants totalling $2,532,000 which have been received pursuant to this agreement are included in government grants in aid of construction.

(d) Gander hangar extension
The company has under construction an extension to its Gander hangar facility which will be completed in 1977. The remaining cost to complete the project is estimated to be $770,000.

As at December 31, 1975, $1,605,000, representing the net book value of the facility, was included in current assets under "Asset held for disposal" based upon the intention of the Government of Newfoundland and Labrador to arrange financial assistance in the form of a sale and leaseback of the hangar facility. However, alternate financial assistance was provided during 1976 in the form of a $1,500,000, 10½% mortgage loan which is included in long-term debt, and a $1,500,000 grant which is included in government grants in aid of construction. Accordingly the net book value of the facility as at December 31, 1976, has been reclassified from current assets and is included in funds applied to property and equipment in the statement of changes in financial position.

(e) Lease of hotel building
On January 1, 1977, the company entered into an agreement to lease a hotel building for a period of five years at an annual rental of $150,000 with an option to purchase the building at any time during the lease term for the sum of $1,650,000.

8. Government Subsidies

Certain of the routes serviced by the company are eligible for federal subsidies. The Canadian Transport Commission has confirmed that the same routes which were eligible for subsidies in 1975 are eligible in 1976, but has restricted the amount of the 1975 and 1976 subsidy allotments to $1,700,000 in each year regardless of the cost of providing these services. Accordingly, although the company has submitted a claim of $3,372,000 (1975 - $2,289,000) for providing these services, only $1,700,000 has been recorded in the accounts in each of the years 1975 and 1976.

9. Gain on Sale of Flight Equipment

Gains of $1,323,000 (1975 - $966,000) realized from sale and leaseback transactions are included in other income and have reduced basic loss per Common share by $0.69 (1975 - $0.46).

10. Remuneration of Officers and Directors

The aggregate direct remuneration paid by the company to its directors and senior officers for the year ended December 31, 1976, was $389,000 (1975 - $331,000).

11. Comparative Figures

Certain figures for 1975 have been reclassified to conform with the current year's presentation.

12. Anti-Inflation Act

The company is subject to restrictions on prices, profits, dividends and compensation under the Anti-Inflation Act.

	1976	1975	1974	1973	1972
Financial ($000's)					
Revenues					
Scheduled Passengers	$ 26,005	$24,983	$22,637	$17,914	$13,304
Cargo	4,587	3,991	3,550	2,750	2,551
Government Subsidies	1,700	1,700	1,725	1,753	1,717
Charter & Other	6,359	5,228	2,911	746	1,382
	$38,651	$35,902	$30,823	$23,163	$18,954
Expenses					
Operating	$35,520	$32,222	$26,282	$17,933	$14,470
% of Revenues	91.9%	89.7%	85.3%	77.4%	76.3%
Depreciation, Aircraft Rentals & Interest	$ 6,941	$ 5,766	$ 4,177	$ 3,438	$ 2,840
% of Revenues	18.0%	16.1%	13.6%	14.8%	15.0%
Deferred Income Taxes	$(1,226)	$(342)	$ 342	$ 1,111	$ 958
Net (Loss) Earnings	$(1,083)	$(190)	$ 506	$ 1,111	$ 981
Per Common Share	$(1.03)	$(0.27)	$ 0.37	$ 0.88	$ 0.97
Funds (Applied To) Provided From Operations	$(1,360)	$(405)	$ 2,654	$ 3,084	$ 2,720
Per Common Share	$(1.23)	$(0.45)	$ 2.16	$ 2.52	$ 2.69
Other Statistics					
Scheduled Operations					
Passengers Carried	593,000	604,000	594,000	539,000	377,000
Pass. Miles Flown (000)	225,000	238,000	239,000	216,000	160,000
Yield per Passenger Mile	11.6c	10.5c	9.5c	8.3c	8.3c
Cargo Ton Miles (000)	3,876	3,799	3,810	3,659	3,460
Yield per Cargo Ton Mile	$ 1.18	$ 1.05	$ 0.93	$ 0.75	$ 0.74
Total Revenue Ton Miles (000)	26,340	27,575	27,666	25,264	19,461
Capacity Ton Miles (000)	50,836	51,532	52,053	47,270	36,933
Revenue Weight Load Factor	51.8%	53.5%	53.2%	53.4%	52.7%
Employees at Year End	787	771	752	640	521
Revenue Ton Miles per Employee	33,500	35,800	36,800	39,500	37,400

Glossary of Terms

CAPACITY TON MILES

Number of tons capacity for the carriage of passengers and cargo multiplied by the number of miles this capacity is flown. A measure of aircraft capacity offered.

CARGO

Freight, express, mail and excess baggage.

CARGO TON MILES

Tons of freight, express, mail and excess baggage carried multiplied by the miles they are flown.

REVENUE PASSENGER MILES

Total revenue passengers carried multiplied by the number of miles they are flown.

REVENUE TON MILES

Total tons of all revenue traffic carried multiplied by the miles they are flown.

REVENUE WEIGHT LOAD FACTOR

Total revenue ton miles as a percent of the capacity ton miles.

YIELD

The average revenue per revenue passenger mile or revenue ton mile.


Churchill Falls
Goose Bay
Wabush
Deer Lake
Gander
Stephenville
St. John's
Iles de la Madeleine
St. Pierre & Miquelon
Charlo
Chatham
Charlottetown
Sydney
Moncton
Fredericton
Montreal
Saint John
Halifax
121
153
705
628
726
495
473
341
314
394
518
130
125
184
240
275
603
532
415
178
187
79
392
410
513
350
382
49
81
162
120
103
98
190
EASTERN PROVINCIAL AIRWAYS

EASTERN PROVINCIAL AIRWAYS

Growing with Atlantic Canada.

Head Office: Gander, Newfoundland

EASTERN PROVINCIAL AIRWAYS AND SUBSIDIARY COMPANIES

Consolidated Statement of Retained Earnings

FOR THE SIX MONTHS ENDED JUNE 30, 1976
(With Comparative Figures for 1975)
(unaudited)

	1976	1975
	(in thousands of dollars)	
RETAINED EARNINGS BEGINNING OF PERIOD	**$4,017**	4,141
NET LOSS FOR THE SIX MONTHS	**432**	260
REALIZATION OF EXCESS OF APPRAISED VALUE OF PROPERTY AND EQUIPMENT OVER COST	**—**	5
	3,585	3,886
DIVIDENDS		
Preferred Shares	**82**	53
RETAINED EARNINGS END OF PERIOD	**$3,503**	3,833

Comparative Highlights for the Six Months

ENDED JUNE, 1976

	1976	1975
EARNINGS		
Revenue - Gross	**$18,381,000**	16,554,000
Net Loss	**432,000**	260,000
Net Loss Per Share	**0.43**	0.24
FINANCIAL POSITION		
Working Capital	**$ 430,000**	2,573,000
Property & Equipment	**19,723,000**	16,894,000
Shareholders' Equity	**6,899,000**	7,479,000
Equity Per Common Share	**4.14**	4.57
SCHEDULED OPERATION		
Passengers Carried	**270,122**	273,062
Cargo Ton Miles	**2,012,366**	1,834,379
Revenue Ton Miles	**12,342,262**	12,576,234
Capacity Ton Miles	**24,036,136**	24,380,829
Revenue/Weight Load Factor	**51.3%**	51.6%

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EASTERN PROVINCIAL AIRWAYS

SIX MONTHS REPORT
JUNE 30, 1976

PRESIDENT'S REPORT

TO THE SHAREHOLDERS

During the six months ended June 30, 1976 the Company incurred a net loss of $432,000 or 43¢ per share compared with a net loss of $260,000 or 24¢ per share during the corresponding period last year. Operating results for the half year under review were adversely affected by the general decline in the demand for air travel particularly business travel in Atlantic Canada. Additionally, the national disruption of air services during the month of June further reduced revenue and caused the Company a loss of approximately $500,000 before deferred income tax. Consequently, the Airline experienced negative growth in terms of the numbers of passengers carried on scheduled services for the first time since 1963.

Mail and freight volumes were 9.7% higher than in the first half of 1975 when mail traffic was adversely affected by postal strikes. Charter revenue was 33% higher than last year and this reflects the utilization of the seventh Boeing 737 aircraft delivered in November of last year. Because of management's forecast of a continuation of the downward trend in air travel demand this summer, the aircraft was leased to an American Airline for a six month period. This action will provide the Airline with approximately $500,000 in funds. The aircraft will be returned at the end of October and it will augment the fleet to provide the charter capacity which has already been sold for the coming winter season.

Comparative 1975 financial information has been restated to reflect the ceiling of $1,700,000 set by the Government of Canada for subsidies to refund the Airline for its losses on certain of its specific routes. Notice of this ceiling was not served on the Airline until August of 1975, however, the Airline has been advised that a similar ceiling has been placed on 1976 operations. As a result of these actions on the part of the Government the Airline has sought and is waiting for a meeting with the proper officials to discuss and rationalize the question of subsidy payable on certain routes eligible for such subsidy in Atlantic Canada. As stated in an earlier report, the Airline may be required to curtail its services on certain routes which are eligible for subsidy.

It should be noted that the gain on the sale and leaseback of the Boeing 737 aircraft previously shown as an extraordinary item on the 1975 Interim Income Statement, has been reclassified to Other Income in order to be consistent with audited year-end presentation.

As a result of substantial increases in airport user charges as well as the imposition of a 20¢ per passenger security charge and recent increases in the price of fuel, the Airline has made application to the Canadian Transport Commission for a fare increase to be effective September 15, 1976. This fare increase will average between 4 and 5% on a systemwide basis.

Your Airline has stated in previous Reports that it desires more longhaul routes. An application is now before the Canadian Transport Commission for non-stop traffic rights between Halifax and Montreal. The date set for the filing of interventions is July 21, 1976. There have been a substantial number of interventions by interested parties supporting the application. The Airline has received only one intervention opposed to the application and this intervention was served on us by another air carrier.

The Hearings of the Canadian Transport Commission relating to our application for a subsidiary air network in the Atlantic Provinces have now been completed. Your Airline management is in no position to hazard a guess as to the date of the decision on the application.

The Airline has under study plans for the complete route rationalization of its system in order to provide for greater economic viability and also better public service. A new non-stop air route between Montreal and Halifax is very important to this route rationalization and also to help the Airline attain a more reasonable return on investment.

It is the opinion of your management that the present recession in Atlantic Canada will continue beyond the year-end. Consequently, it is not anticipated that 1976 will be any better than 1975. In fact, your management believes that the scheduled airline industry throughout the nation may very well find that 1976 will prove to be a year of higher losses than 1975. Your Airline will continue striving for more economies and as the two major capital improvements in Gander and Halifax are completed in the fall of this year we will be in a position to operate in a more efficient manner than at this time. These efficiencies will be both physical and economic in nature.

K. A. Miller

K. A. Miller
President and Chief Executive Officer

EASTERN PROVINCIAL AIRWAYS AND SUBSIDIARY COMPANIES

Consolidated Statement of Earnings

FOR THE SIX MONTHS ENDED JUNE 30, 1976
(With Comparative Figures for 1975)
(unaudited)

	1976	1975
	(in thousands of dollars)	
REVENUE		
Scheduled Operations	$13,696	$12,937
Government Subsidies - 1976 Estimated	900	900
Charter and Other	3,785	2,717
	18,381	16,554
EXPENSES		
Operating	19,101	16,431
Depreciation and Amortization	913	930
	20,014	17,361
LOSS FROM OPERATIONS	1,633	807
OTHER INCOME	1,461	1,128
	172	(321)
INTEREST AND DEBT EXPENSE	899	781
LOSS BEFORE INCOME TAXES	1,071	460
DEFERRED INCOME TAX REFUND	639	200
NET LOSS	$ 432	260
LOSS PER SHARE	$ .43	.24

Consolidated Statement of Changes in Financial Position

FOR THE SIX MONTHS ENDED JUNE 30, 1976
(With Comparative Figures for 1975)

	1976	1975
	(in thousands of dollars)	
FUNDS PROVIDED BY		
Long Term Borrowing	$1,674	83
Sale of Fixed Assets	6,383	8,256
Preferred Share Issue	—	1,020
	8,057	9,359
FUNDS APPLIED TO		
Operations:		
Net Loss for the Period	432	260
Non-Cash Charges Against Earnings - Net	873	(38)
	1,305	222
Property & Equipment		
Aircraft and Spares	631	1,692
Other	1,869	558
Long Term Debt	4,728	4,928
Investments	(145)	293
Dividends	82	53
Pre Operating Expenses	238	628
Redemption Preferred Shares	51	27
	8,759	8,401
INCREASE (DECREASE) IN WORKING CAPITAL	$ (702)	958